THE OWEN-GLASS BILL: SHOULD THERE BE FOUR OR EIGHT FEDERAL RESERVE BANKS?

THE amendments to the Owen-Glass Bill submitted by the two Senate committees show most satisfactory progress in many respects, and we may congratulate ourselves that complete agreements have been reached upon many fundamental questions. On two main points, however, the two committees still earnestly disagree; these are the number of the Federal Reserve Banks, and the control of their management. It is fortunate that in this part of the controversy each side is right and each side is wrong. For this situation carries in itself the possibility of a wise compromise.

Senator Hitchcock and his friends are to be congratulated on the sound stand they have taken in the question of the reduction of the Federal Reserve Banks to a maximum number of four. There is absolute unanimity among all students of the question that the establishment of a discount system, bringing about fluidity of credit and reserves, can best be secured by one central bank. The writer has gone to particular pains to gather the expressions of views of the most prominent men in Europe, among whom are the presidents of a number of European central banks, leading financiers and heads of the largest financial institutions of Europe. They all agree that one central bank would be the best means of developing a discount system. While a majority insist that this is the only way, a few concede that there is a possibility of developing a discount system with several central banks. But all agree that in that case there must be as few as possible and that they must be tied together in an effective way by a business management free from political influence. They also state that if Europe is to be counted upon as an investor in our future American discounts, it will be a prerequisite that there be a free market for such discounts at home. It is clear

that unless the European investor can count on his ability to resell such discounts in case he should desire to do so, he would have to consider the purchase of American discounts as an undesirable lock-up of money. If Europe should hesitate to take our American paper freely, our discount system will lose 75% of its beneficial power. That a discount market would develop with a system of eight Federal Reserve Banks, is out of the question. I do not wish to tire the reader by repeating the arguments which I have already advanced in a previous article,[1] but I venture to append quotations from some of the letters of these European authorities.[2] I am giving only abstracts from these letters, omitting the strong arguments they contain for a central bank and against a note issue by the government, these two points having passed beyond the phase of further deliberation in the present controversy. These men, some of whom are at the head of institutions of the same character as those that we are about to create here, state in unmistakable terms the grave dangers that would arise from a political influence in the management of such banks, and it is on this question that Senator Hitchcock and his friends go astray, while the views expressed in this respect by Senator Owen and his colleagues cannot be too emphatically endorsed. We need not enlarge upon the consequences that would follow a government management of the branches. It might debase and corrupt our entire political life, if the fate of the management of the Federal Reserve Banks and their branches should become the plaything of politics. No matter how we safeguard the government management in the beginning, a nation that flirts with the recall of judges may at any time break down safeguards that we may now impose and all the offices, from that of director down to that of hall porter, may become the spoils of the conquering party. One need not emphasize what consequences this might entail for our political and business life.

[1] *Cf.* p. 173, *supra*.

[2] The quotations appearing as an appendix in the original pamphlet are here omitted.—Ed.

In dealing with the question of whether there should be four or eight Federal Reserve Banks, we have to concede that in certain respects both sides are right.

From the point of view of securing a strong system and of safeguarding a possibility of developing effective discount markets, there should be only four. From the point of view represented by the Owen wing, that an intimate touch ought to be established between the management of each Federal Reserve Bank and the district which it represents, and that each district should be certain of receiving the fullest consideration it is entitled to, a system of eight Federal Reserve Banks would appear desirable. Furthermore, it is true that, if we pipe-lined all branches up to four points, a great many of these branches would be located far away from the points of concentration, that the machinery would, therefore, not respond quickly enough and that the sympathetic touch might be lost. The object to be achieved then is to secure the concentration into four units, strong and independent enough to stand on their own feet and to develop fluidity of reserves and a discount market of their own, without at the same time losing by such concentration the necessary touch with the constituent communities.

The writer has repeatedly expressed his belief that in preparing this law insufficient attention has been given to the question of the branches. It is at the branch office that the actual business will be done. Any favoritism or any unfair discrimination will express itself at the branches, where bills are handed in for discount. Sound judgment and business knowledge must be shown here, where alone the character of the bill can be scrutinized and understood. It is therefore most important that the board of these branches be wisely constituted, and the law, to the mind of the writer, errs, when in this most important point it simply leaves discretionary power with the Federal Reserve Board and the Federal Reserve Banks. In the writer's opinion the law should not begin by prescribing the election of the Federal Reserve *Bank's* board, but it should begin by providing for the election of a board of each *branch*. Let the organization committee or

the Secretary of the Treasury designate those 70 or 80 cities where branches are to be established, and provide that the member banks allotted to each branch elect their board on lines similar to those provided by the Owen-Glass Bill for the election of the board of the Federal Reserve Banks. The writer would then suggest that Class "A" be elected by the member banks and that the representatives of these member banks on the board be permitted to be directors or even officers of member banks. They should have a slight majority in the board, while Classes "B" and "C" should be appointed by the government. Directors of Classes "B" and "C" would be elected from classes other than bankers; Classes "A" and "B" would constitute the discount committee, Class "C" would become the committee on supervision. The chairman of this committee on supervision would act as chairman of the board. We should in this way constitute a local board which would be representative of all classes, which would command the local knowledge necessary to deal with the local paper, and in which the government would secure a vote and absolute supervision.

The plan that I have in mind would then provide for the establishment of eight regional Federal Reserve Banks, each, let us assume, with about eight branches. But each regional reserve city, for its own local business, would have to be treated exactly like a branch, and therefore we should have, including the regional reserve city, up to nine organizations, or, let us say, nine branches in each region, being a total of about seventy-two points at which offices would be created. It is not necessary to start with the full number of these branches in each case, nor need it be limited to eight. However, I am inclined to think that there will not be much less than 72 when the whole organization has been mapped out and there will be many more as the country develops.[1]

[1] While the suggestions here made appear to be radical they can be embodied into the law with comparatively few changes not disturbing the general lines of the bill. They follow the structure of the Banque de France and the Reichsbank, where there are local boards at the main branches. As the system develops, agencies or sub-agencies are established as feeders of the

Let us now assume that the law is amplified, so that a number of these branch banks (let us say up to nine), would, in forming one regional reserve bank, elect a board consisting of one member to be designated by each branch bank.[1] We should then have eight regional reserve banks, let us say at New Orleans, St. Louis, Chicago, Cincinnati, New York, Boston, San Francisco, and at some other far-western point, *e. g.*, Denver.

I should now propose that in each case two regional reserve organizations be linked together into one district, so that New Orleans and St. Louis would form one District Federal Reserve Bank, with its head offices in St. Louis. The Chicago and Cincinnati District Federal Reserve Bank would have its seat at Chicago. Boston and New York would together form a District Federal Reserve Bank at New York, and the Denver and San Francisco Federal Reserve Bank would probably have its seat at Denver.[2]

The boards of these District Federal Reserve Banks would be constituted of four members each, to be designated by each regional reserve bank, and to these would be added the governor and two deputy governors to be appointed by the President of the United States. They would be chosen from lists to be submitted to the President by the eight members of

branches, or the number of the latter is being increased. The Banque de France has now one head office, 128 branches with local boards and 71 auxiliary offices and 312 agencies, together 383, which are attached to the branches. The German Reichsbank has now one main bank at Berlin and 20 main branches with separate boards, in addition 76 branches and about 400 side branches.

[1] If there should be less than five branches, each branch might designate two members.

[2] If it were thought wise to have three regional reserve banks to cover the Pacific Coast, it could be done under this plan without interfering with its general structure. There might be three regional reserve banks, *viz.*, one at San Francisco, one at Seattle, and one at Denver or Salt Lake City. The three would have one stock capital, and each would designate one-third of the members to the district board, which would have its seat at the most centrally situated point,—probably Denver or Salt Lake City. Similarly if at a later time it should be found that Pennsylvania and Maryland should be divorced from New York, the New York district might be divided into three regions instead of two.

the board of the District Federal Reserve Bank; the President having the right to reject these lists entirely, asking for new names. If, after three lists had been submitted, the President and the District Federal Reserve Bank could not agree, the President would choose from one list to be submitted by the Federal Reserve Board. The governor would be in charge of the District Federal Reserve Bank, the two deputy governors would be placed in charge of the regional federal reserve banks. The stock to which all the banks of the various branches subscribe would be that of the District Federal Reserve Bank.

If we review at this point the advantages that would be gained by a plan of this kind, it will become apparent:

First: The unit of each district is large enough to include varied forms of industrial, agricultural and commercial interests, so that the district will be able in itself to comply more readily with the demands that may spring up from time to time.

Second: For transfers and collections, the boundary line within which these will move freely has been enlarged.

Third: The local character of the branch boards which will deal with each individual case has been preserved, but the character of the board of the District Federal Reserve Bank, which will have to deal exclusively with larger problems of policy, from a higher point of view, without consideration of individual wishes, has been delocalized; it has lost its provincial character, all districts being represented.

Fourth: The four districts so created will be large enough to command confidence, and large enough to enable the development of discount markets. At the same time, the equality between all branches and between all regional banks has been preserved. For its local transactions the central point, *i. e.*, New Orleans, would have a board, constituted exactly like that of a branch, *e. g.*, Dallas. For its dealings with its branch banks, the regional of New Orleans would be in exactly the same position as that of St. Louis, and the District Federal Reserve Bank of St. Louis would be constituted from as many members of the New Orleans organization as that of St. Louis.

Full consideration has therefore been given to the apprehension that, by concentration, the sympathetic touch, to be preserved for each region, might be weakened, and that the central points might gain at the expense of the minor points. An organization of the kind here proposed would remove the reason for any such fear, the parity among all eight cities having been strictly safeguarded.

Fifth: If the plan be carried out that a portion or all of the stock of the Federal Reserve Bank is to be owned by the public, it stands to reason that the latter would much rather buy the stock of a larger organization than that of a smaller one, because the smaller ones are apt to feel to a stronger degree any losses that might be incurred. Moreover, the market for the purchase and sale of these stocks would be a more reliable one, if there were only four different kinds of stock, than if there were eight or ten.

Sixth: If at any time it should be found desirable to subdivide the districts into a larger number of regions, there would not be any difficulty in doing so under this plan, while the difficulty of reshaping the districts would be increased if stock had been sold of too many organizations.

It might be well to explain at this point what would be the functions of each of these three boards. The underlying principle of an organization as here proposed would be that each branch should be credited with the amount of the capital stock subscribed by its member banks and the aggregate amount of its deposits. On the other hand, each branch would be debited with the aggregate amount of its investment in commercial paper as well as its proportion of United States government bonds taken over and the circulation taken out by the regional federal reserve banks. Each branch once a week would give its status to the regional bank, which would consolidate all statements of the branches into one, showing the position of the regional bank. Each regional bank would then send the consolidated status and that of the individual branches to the District Federal Reserve Bank, and the latter would consolidate the statements of the regional banks into one, and send the same, with such additional in-

formation as might be required, to the Federal Reserve Board, which would publish regularly the consolidated and individual statements of the four District Federal Reserve Banks.

The regional board would apportion the funds among the branches, permitting, in its discretion, one branch, as a matter of bookkeeping, to draw on the funds of the others, or rather, to go deeper into its own reserves, judging by the consolidated status of all its branches the measure up to which each branch may be accommodated. In such deliberation it would be guided, of course, by the fact of whether or not such demands made by any branch were based upon seasonable and sound requirements. The District Reserve Board would, in turn, apportion in a similar way the funds between the two regionals, taking into full account the status of each regional and of its branches. It need hardly be repeated that fairness of dealing would be assured by having each regional board consist of members from each branch and by having the district board constituted by an equal number from both regionals.

The discussion just begun on the Senate floor has already shown the absolute necessity of dealing more explicitly with this question of branches. Atlanta desires to be made a federal reserve city, because she objects to being forced to rediscount at New Orleans. If this claim should be granted there would be a great many cities, equal or more important in size and banking power, which would justly insist on the same privilege. The consequence would be, that a large number of small and weak reserve districts would be created, a system which would be doomed beyond doubt. The plan as proposed by the writer would easily solve this problem in one of two ways: One method would be to subdivide the district into more than two *regions*, which could be done without weakening the power and basis of operation of the district. The other way would be to have Atlanta satisfied as a branch. If Atlanta understood that for her local business she would have a local, independent board, just the same as New Orleans, if she understood that the bills rediscounted at Atlanta will

normally remain until maturity in the hands of the Atlanta branch, if she understood that in the regional board she has the same vote as New Orleans, and that for the running of the business of the regional it is as immaterial whether the board be located at Houston, Dallas, Atlanta, or New Orleans, as it will be immaterial whether the district board is located at St. Louis or New Orleans, she should and would be quite satisfied to become a branch.[1] The actual business would be done by the branches, and the administrative organizations at the regional and district points would have the same neutral composition wherever they happened to be located. As the bill is drawn at present, it is quite unclear how these branches are to be constituted and what powers they are to have. If they were to be only agencies, run by managers, who would discount bills subject to the approval of the Federal Reserve Bank and who would have to forward these bills to these head points, Atlanta's objection would be fully justified. Moreover, such a slow and cumbersome system would prevent the development of a free discount system which should make the sale of discounts as quick and as responsive as the calling of a demand stock-exchange loan. It is to be assumed, however, that the framers of the Owen-Glass Bill have in mind some system of this kind. If they have not, if they intend to give local boards to each branch, it would be advisable to state this clearly and to let the member banks of the district of the branch have a voice in selecting some of the directors whom they know and trust. This would be better than to have the entire local branch board appointed by the Federal

[1] A Federal Reserve Bank including all the national banks of both Atlanta and Savannah would have a capital (on the basis of 6% of capital and surplus) of about $600,000 and deposits of $600,000 to $1,300,000. The Federal Reserve Bank, on a very liberal calculation, would then have resources of its own of less than $2,000,000. In normal times it might grant accommodations of $700,000, in strenuous times it might grant another $600,000. How long would it be till the Federal Reserve Bank of Atlanta would have given all the accommodation it could provide and would have to put its rates so high that any additional requirements would be satisfied from other quarters?

Would not Atlanta fare better and be more secure if she were part of a larger organization? The Atlanta rate would remain more stable and, as a matter of fact, Atlanta would be in a more dignified position.

Reserve Bank's board, on which there would probably be one single member only representing the district of the branch. Furthermore, as the Owen-Glass Bill is drawn at present, the anomaly would arise that any Federal Reserve Bank board would probably not have more than one single member who would be competent to pass on the local discounts of that federal reserve city. To illustrate: The Federal Reserve Bank board of New York would probably be constituted of members from New York, Philadelphia, Pittsburgh, Baltimore, Washington, D. C., Buffalo, Rochester, and possibly Boston. This composite board, on which there would not be more than one New York member, would have to pass on all the New York paper to be discounted by the New York Federal Reserve Bank. This is, of course, a dangerous and impossible situation. There should be in New York a local committee or board, as there should be in Philadelphia, and the composite board should deal only with questions of general policy, direction and supervision.

If the Federal Reserve Bank board or the Federal Reserve Board at Washington, or both together, should have the power to appoint all local boards or to pass exclusively on all purchases of discounts, there would be too much concentration of power in a small group of men,—the very thing that this legislation is planned to avoid.

It is not from a desire to be critical, but from a wish to be helpful, that these defects have been pointed out at such length. The writer is convinced that unless this question of branches be considered with more care a satisfactory system will not be created. There will be either a scattering of reserves or there will be a well-grounded apprehension of too much concentration of power.

Whether there be 4 Federal Reserve Banks with each about 16 branches, or 4 District Reserve Banks with 2 (or more) regionals, each with 8 branches, is of smaller importance. The writer strongly believes that the latter system is the better, because it will create clearer statistics and, for the governor in charge, a problem easier to handle.

This question of eight or four Federal Reserve Banks will be

easily understood if we translate it into military language. Should we be able effectively to maneuver eight armies, if we entirely disconnected them, not permitting them to communicate with one another or to come to one another's assistance, except by way of reporting to headquarters at Washington? Should we not have a better chance of success if above the generals in charge of each two of these armies we placed one leader, who had authority to detach reserves from one army and throw them to the assistance of the other, or throw both armies into one and divide them again, without costly and dangerous delay and long explanations which might be only half understood at headquarters? Would not the two armies feel safer and more certain of success? Would they not in fact be stronger than each standing alone? Again, would not the two army corps be better organized by having each an able general and one leader above them, than if the one leader were to manage alone the sixteen armies constituting the two army corps?

If the system is to succeed, the units by combination must be large enough to stand alone. If any one of them is so weak that it will frequently have to appeal to others, it will interfere with the others' safety and efficiency. Because, no matter how well the others might keep their own house in order, they could not foretell what their own available resources might be the next day.

Moreover, if these units, though large, are to show a clear picture, which must be fully understood in all its details, if the local and the Washington managements are to be successful, then men and figures must be grouped. The figures must be clarified and simplified and they must crystallize in the brain of the man in charge at each point. The four governors heading the four district Federal Reserve Banks must rely for their information on the two deputy governors in charge of the regionals, as these in turn would depend on the managers of the branch banks. It is not only the larger financial strength that is an absolute prerequisite for an effective system; it is just as important to reduce the problem to so simple and clear a form, assembling men and material,

that the Federal Reserve Board can intelligently and successfully deal with it.

It has been claimed that the Federal Reserve Board is not an administrative body, but merely a supervisory board. Nothing could be farther from the truth. If this system is to be crowned with success, the Federal Reserve Board must be an administrative board, and the larger the number of Federal Reserve Banks the more far reaching would become the power and administrative duty of the Federal Reserve Board.

An effective discount policy, an effective gold and foreign exchange policy and an effective method of dealing with the one-year treasury notes and 3% government bonds can be secured only by a strong and intelligent Federal Reserve Board. On the other hand, intelligence in all these very intricate questions can be displayed by the Federal Reserve Board only if it is in intimate touch with the conditions that exist, not at each point in this country alone, but also in each country of the entire globe. It is impossible for the seven or nine men, sitting in Washington in happy seclusion and far away from the business centers, to deal with these questions wisely, unless intimate touch with those centers be established where all these threads converge. It is true that in crystallizing the problems of the country up to four points the difficulties of the Federal Reserve Board will be materially reduced.

Instead of dealing with eight parts and instead of having the duty of equalizing reserves by helping one out of eight—and simultaneously of singling out one or more out of seven on whom to draw,—the problem would be reduced to judging one case out of four and distributing the burden among the other three. It is even more important that this question of distribution (which with eight centers might easily become a question of retribution), come before the board only rarely if at all. As to the problem of dealing with bank acceptances, foreign exchange, government bonds and gold, it is much easier to bring about an understanding between four members from large units that have lost their provincial character, than between eight units, where each would have in mind only the advantage of his own little corner.

While the problem has thus been simplified, and while it is conceivable that of the seven or nine members of the Federal Reserve Board, four might be delegated each to take particular charge of one of the four districts, the governor general and the other members of the Federal Reserve Board would still receive their information by an indirect and ineffective method. It would be infinitely better and would immeasurably strengthen the Federal Reserve Board, if the four governors of the four districts (who would have been appointed by the President) should actually become members of the Federal Reserve Board. These four governors would contribute and impart in a direct way to the other members of the Federal Reserve Board the actual business knowledge necessary to assure a wise management. At the same time a sorely needed opportunity would be given to these four heads of the four district banks to meet one another and to discuss with one another conditions as they existed in each district. This would enable them to form a clear judgment, not only of the conditions governing their district, but also of those of the other districts, and thus help them to decide upon a wise policy to be pursued by the Federal Reserve Board, not only for the entire country, but also for each district. In this respect the bill as drawn at present is entirely defective, because it does not provide at all for an exchange of views between the heads of the various Federal Reserve Banks. They run along disconnected from one another, where they should understand and help one another.

The advisory board as planned will not fill the gap. The men on that board cannot possibly have the knowledge, nor speak with the authority of the heads in actual charge, whose main duty it would be to understand and to explain the conditions of their particular district. Moreover, if these four heads, who are responsible for the weal and woe of their district, should have a vote on those questions that so deeply touch their own fate, there would be more confidence in every part of the system that conclusions, no matter whom they might hurt, had been reached with full knowledge, for the best of the country, and without fear or favor.

I should suggest that the Federal Reserve Board be cut into two parts, the one the discount committee, to consist of these four heads together with the governor general and two deputy governors general, to be appointed by the President; the other the committee of supervision, to consist of the Secretary of the Treasury and such other members as may be designated by the President. The discount committee would deal with all questions of routine and of business; the board of supervision would be in charge of the supervision of the entire system. Both together would form the Federal Reserve Board, which would pass upon all questions of rules and regulations. The discount committee should be able to act only with the consent of the governor general or the acting deputy governor general, and in case of disagreement, the question would have to be brought before the full board, where the Secretary of the Treasury would preside and would have the casting vote in case of a tie. The object of dividing the board in this way will be apparent without much explanation: It takes the government official out of the embarrassing position of normally passing upon questions of business, for which the governor general, appointed by the President, would be mainly responsible, but it gives him supreme power in case of a tie. Furthermore, it gives him supervisory power—which should be primarily the government's function—over the entire system.

The plan as here proposed appears to the writer as a compromise which might be acceptable to both sides to the controversy. It preserves the larger number of the regional reserve banks and branches which insure local independence and local sympathetic understanding, but at the same time it combines eight disconnected and weak units into four larger and stronger ones, which will be necessary for the development of any effective discount system.

As far as governmental influence is concerned, the government secures supervision from top to bottom. It secures a management appointed by the government at the top and down to the middle, where the functions of the regional and district Federal Reserve Bank boards will be those of ap-

portioning funds and of advising and deciding upon the rates at which accommodation should be granted. It leaves the majority at the branches in the hands of business men with a strong share in the management of men appointed by the government, with a strict supervision not only by the government, but also by the regional banks.

While the highest authorities of Europe, whose system, after all, we are copying, are practically a unit in stating that a perfect discount system can be established only through one single bank, I most confidently believe that—considering all the requirements of our case—we are safe and wise in starting with four units, provided they be properly organized and managed. But nothing will change my profound conviction that a system of eight Federal Reserve Banks, as now proposed, will end in failure. An effective discount rate is the link between the lever and the brake. Without an effective discount rate no European central bank would be able to stand. With eight independent districts (and even with six), no discount market can possibly develop. The safety of the system will be lacking, the member banks' funds will remain largely, as before, in the New York stock exchange. It seems scarcely justifiable to legislate the national banks into a position where they either would have to abandon their national bank charter and suffer a material loss on their government 2% bonds, or where, as the only alternative, they would have to throw in their lot with a system that, if carefully administered, could bring only very little relief and which, if managed without such extreme conservatism, would be bound to collapse. If the system be amended on lines as here proposed, objections against such constraint will largely be dispelled, and it might be expected that even a majority of the state banks and trust companies would join.

A management of great ability might, by its sagacity and impartiality in equalizing reserves, gradually diminish to a certain extent the only too natural apprehension and distrust of the banks. It might, in spite of the law—by encouraging meetings of the heads of the Federal Reserve Banks among themselves and with the Federal Reserve Board at Washing-

ton,—bring about, to a certain degree at least, the much needed coöperation. But, as planned at present, the heads of the eight or ten Federal Reserve Banks would be so busy at home and half of them so far away, that frequent trips to Washington would be impossible. The plan of having *district* Federal Reserve Banks would cure this defect, because the trips would be cut in two and the absence from duty would thereby be reduced to a minimum. The San Francisco manager would once or twice a month go to Denver, where he would meet the head of the Denver and Seattle regional banks. The governor of the Pacific district, living at Denver, would once or twice a month go to Washington. Moreover, as the Denver governor's duties do not entail any large amount of detail routine work, he would have and should have the necessary time for extended conferences at Washington. But any wise management, no matter how hard it tried by administrative measures to overcome the defects of the present bill, would be forced to remain close to the shore. The rates would have to be kept high and changes would have to be made frequently in order to keep the district from getting overcrowded or from upsetting the stability of the other districts. The men in charge, both at Washington and at the Federal Reserve Bank points, would work under a fatal handicap, which it would be cruel and reckless to inflict upon the nation.

It will take a few hours only to amend the bill on lines as here proposed; it will take weeks, and possibly months, of acrimonious debate if a proper basis for a compromise on these two questions cannot be found.